STATES OF JERSEY

GOODS AND SERVICES TAX: EXEMPTION OR ZERO-RATING FOR FOODSTUFFS AND DOMESTIC ENERGY (P.28/2009) – COMMENTS

Presented to the States on 30th March 2009
by the Minister for Treasury and Resources

STATES GREFFE

COMMENTS

1. Summary

Deputy Labey has put forward a proposal to exempt or zero-rate the supply of foodstuffs (in line with U.K. VAT treatment) and domestic energy under the Goods and Services Tax (GST). At the same time the Deputy has requested the Minister for Treasury and Resources to investigate alternative progressive tax measures to restore the lost revenue.

This is not the first time the States will have debated such a proposition. Deputy Labey lodged a similar proposition in August 2008 and in total the States have debated GST exclusions on four previous occasions.

In rejecting all of these earlier propositions, the States has consistently taken the view that it would prefer a simple broad-based tax with a low rate with targeted support to the less well-off, rather than a complex tax with a higher rate and blanket exemptions.

While the overall savings to households from the exemptions proposed by Deputy Labey would be £6 million, the vast majority of this benefit would go to higher income households. Low income households would benefit from these exemptions to the tune of £90 a year. The saving to high income households would, on the other hand, be £240 a year. Indeed of the £6 million in tax given away by this proposal, £3.5 million would go to high income households and only £2.5 million would go to low to middle income households.

In contrast to this proposition, the States has until now preferred a more targeted approach which, through increases in income support and tax exemptions, has provided a total of £12 million in assistance to those on low-to-middle incomes. This is considerably more than the £2.5 million benefit to low-to-middle income households which this proposition would provide if it were to be approved. Also, in accordance with the States' decision of 23rd September 2008 (the 'Le Fondré' amendment), £6 million of increases in benefits and tax exemptions would be reversed if Deputy Labey's proposition were approved.

Alternatively, the £6 million reduction in tax revenues would not only have to be replaced, probably through an increase in the rate of GST to 4%, but also extra revenues would have to be raised to cover the estimated £200 – £300,000 additional cost of administration. Administrative costs to businesses would also rise, which ultimately will be reflected in increased prices to consumers.

Now is not the time to be considering such changes. With the world economy in turmoil, Jersey predicted to enter recession, and challenges to our finance industry, the last thing we should be considering is permanently eroding our tax base. In addition, we would be going against external and independent advice from the Fiscal Policy Panel and H.M. Revenue and Customs which emphasized the need to keep GST unchanged for 2 years.

GST is only part of the fiscal strategy package. Through the combination of ITIS, '20 means 20', GST and income support, we have introduced a progressive package of measures which has involved the greatest changes to our tax system in over 60 years. What is needed now is a period of stability which allows us to retain GST at the low rate of 3% for as long as possible.

2. Background

In 2004 the States agreed to introduce the "zero/ten" corporate tax structure in order to retain the finance industry and hence secure the economic future of the Island.

However, the overall effect of "zero/ten" will be to reduce Jersey's future annual tax revenues by approximately £100 million.

In order to fill this anticipated revenue gap, the States agreed a package of measures that included –

- restrictions on States spending;
- an economic growth plan;
- an Income Tax Instalment System;
- a phasing-out of Income Tax allowances for higher income groups ("20 means 20");
- an integrated and enhanced system of income support; and
- the introduction of a simple Goods and Services Tax (GST).

The overall effect of this package, because of Income Support, plus the phasing-out of income tax allowances for those on higher incomes, is progressive, i.e. those on low incomes have been more than fully insulated from GST through enhancements to income support; those on middle incomes have had the effect of GST mitigated through increases in income tax exemptions; and those on higher incomes pay the full amount of GST and also pay more income tax.

3. Previous propositions on GST exclusions

Despite the States' approval of a simple GST system there have been a number of attempts to exclude further items from the tax base. Since May 2005 the States have debated GST exclusions on four separate occasions, most recently in September 2008 with P.103/104. The latest proposition will be the fifth debate on GST exclusions.

4. Why did the States adopt a simple Goods and Services Tax (GST)?

VAT/GST systems have been the subject of academic research over the last 10 to 15 years and the IMF has adopted terminology to describe the 2 main systems that have evolved. The mature EU type system introduced in the 70s is termed "Complicated" and the GST systems introduced from the mid-90s are "Modern/ Simple".

A **simple** GST is one that has a broad base and a single positive rate. It has few zero-rates (other than for exports, international transport of goods and persons and the supply of residential accommodation); few exemptions (beyond the usual ones for small traders, the financial sector, postal services, etc.); and an invoice-based collection and administration system, with as few special schemes as possible.

Being a tax with a single positive rate, the simple GST minimises the costs of compliance for the traders and suppliers. The costs of administration for the government agencies are also low.

The simple GST also ensures that the effective burden of the tax on the consumer is exactly the same as the nominal rate of the tax and the customer knows exactly what he is being charged by way of GST. The tax therefore treats all consumers fairly.

A simple GST treats all businesses uniformly, with minimum deviations, and thus minimises the distortions in the allocation of resources in the economy. It also maximises the revenue yield for the States at the lowest possible tax rate.

A **complicated** GST, on the other hand, is one that consists of many more exclusions (mainly zero-ratings, exemptions and special schemes) all of which narrow the tax base, complicate tax administration and make tax compliance cumbersome and costly for the business community.

Traders with a mixture of sales of zero-rated, exempt, and taxable supplies have to keep separate accounts for each of these categories of sales, imposing on them a significant additional burden of compliance. Some businesses can also easily be tempted to evade taxes on their taxable supplies, but even if not attempting to evade, can innocently make errors on their now complicated returns which need investigating and correcting, thereby adding to administration costs.

Extensive zero-ratings and exemptions generate continuing pressures from other sectors that are involved with charging tax on supplies for equity and therefore zero-ratings, exemptions, or special treatments for them as well.

By virtue of its narrower tax base, the complicated GST also requires a higher rate to yield a given amount of revenue than does a simple broad-based GST – i.e. fewer items attract a higher rate of tax to achieve the same revenue yield.

The traditional, complicated model of GST has, for the reasons above, generally been superseded throughout the world by the simple broad-based model of GST, with few exclusions.

The GSTs of Singapore and New Zealand are examples of simple, modern GSTs while VAT in the United Kingdom is an example of the traditional complicated GST model that has been largely discredited. The items for exclusion listed in this Proposition are essentially lifted from the U.K. model.

It has been asserted that the States has already lost the aim of a simple tax by agreeing to a number of exclusions including education, child care, and medical supplies. This is incorrect. The exclusions to date have focused on targeted supplies of services, rather than goods, supplied by registered professionals or establishments that are easy to identify (mainly through other statute), such as schools, and the tax system remains simple.

On the other hand, the administrative implications for processing the proposed exclusions of certain goods on imports, and for businesses having to account for mixed rates of tax, are enormous. The exclusions for goods now being proposed would dramatically increase the cost, for both the States and business, of accounting for and collecting the tax, and ensuring compliance.

The simple system was the unanimous choice following a period of public consultation conducted by Crown Agents in late 2004. It is not just Jersey that has reached this conclusion. Every country currently going through the same process and

considering the implementation of a GST/VAT has arrived at the same preferred option. For example, Malaysia, Bahamas and Dubai are at different stages on the GST roadmap but have all discounted the U.K./European style system in favour of the New Zealand/Singapore-inspired "simple" broad-based low rate model.

5. What further exclusions under this proposition will mean

If further exclusions (by zero-rating) were to be approved by the States the main implications are as follows –

- The tax base is reduced and tax revenue is lost (see also Section 6 below);
- We complicate the system – which inevitably increases businesses costs (see also Section 7 below);
- The tax becomes more difficult for the business community to understand and comply with (see also Section 8 below);
- The workload of the revenue agencies involved (Income Tax and Customs) will increase and they will need additional resources (see also Section 9 below);
- As a result of the complications further tax revenue will be lost from reduced compliance; and
- The States would need to consider making up the shortfall in revenue and review the previous benefits provided to insulate the lower income groups against GST costs.

6. Revenue loss

If this proposition is approved in full with all supplies being treated as zero-rated then the direct loss of revenue would be in the region of £6 million or approximately 15% of the domestic yield from GST. Unfortunately this is not the only loss. Further exclusions, particularly those for food, would add substantial complexity to the system which would reduce the level of voluntary compliance and therefore tax revenue.

7. Complexity

The impact of exclusions on the complexity of GST is dependent on the supplies involved; the type of exclusion given and the number of businesses involved. Based on the assumption that zero-rating would be the preferred type of exclusion, the overall impact assessment for increasing the complexity of the tax is very high for food and low for domestic energy. Taken together the overall impact assessment would be very high. The paragraphs below provide further comment on the exclusions proposed under P.28/2009 –

Food

The exclusions proposed are based on the U.K. VAT model which is regarded internationally as one of the most complex systems in the world and is even non-compliant in terms of the European Union (EU) directives on VAT harmonisation (see

Section 12 for further details). The following analysis has attempted, where possible, to follow the U.K. VAT interpretation on liability, but the difficulties, even after over 30 years of live tax experience, are striking.

The U.K. exclusion for zero-rating "food" includes 4 general items as sub-categories –

1. Food for human consumption;
2. Animal feedstuffs;
3. Seeds of plants;
4. Live animals.

There is no specific legal definition for food (but it includes drink) – "it is what the average person would consider it so" but it excludes catering and a list of 7 excepted items (including ice-cream, confectionery) and a further 7 items overriding the exceptions.

Retail shops selling food, confectionery, beverages and other household items will have to identify, for every individual item they sell, whether or not it is subject to GST, and they will need to maintain sophisticated systems to collect and account for the tax. However, in many ways the compliance impact will be easier for large retailers of pre-priced/pre-packed food products imported from the U.K.

From the list above it easy to see that many other business sectors will be affected. Hotels, cafés, restaurants, takeaways, and sandwich shops would have different rates of GST for food (hot soup, sandwiches, cereal bars and apples) which will vary yet again depending whether they are consumed on, or off, the premises. Bakeries will have to determine the liability of many products – biscuits and cakes are zero-rated as food but confectionery is taxable. Chocolate-chip biscuits are zero-rated if the chocolate chips are included in the dough or pressed into the surface. Chocolate shortbread biscuits are taxable. Even cake decorations take on different liabilities – chocolate chips are zero-rated whereas chocolate buttons and flakes are taxable.

Mention has been made during previous debates specific examples of U.K. food liability which inspired ridicule elsewhere in the world (the Jaffa cake and Gingerbread man). After 30 years of tax experience the U.K. is still having difficulties in definition – a recent Tribunal case ruled that the supply of Pringle crisps is eligible for zero-rating as they are not considered to be crisps (based on the content mix of potato and maize).

Pet shops and garden centres will be affected. Animal feedstuffs are zero-rated but pet food is taxable. But rabbit food is zero-rated whereas guinea pig food is taxable. Hay and straw if sold as animal feed would be zero-rated, but taxable if sold as bedding. Seeds and plants grown for human consumption or animal feedstuffs are zero-rated – grass seed is zero-rated, but not if pre-germinated and turf is taxable. Flower plants and seeds are taxable, other than specifically listed edible varieties.

Farmers, butchers and fishmongers will also be affected. Bones and off-cuts of meat sold as pet food would be taxable, but if sold for making soup would be zero-rated. Meat and dairy animals would be eligible for zero-rating as would rabbits (other than ornamental breeds) even if kept as pets. Honey bees would be eligible for zero-rating but bumble bees are taxable.

Increasing the complexity of the tax, with mixed rates, provides in-built opportunities for error, or worse, fraud, by miscoding whether goods sold are subject to tax or zero-rated. Not only does this reduce revenue yield, it also requires the States to employ additional staff to monitor compliance.

Every type of exclusion in terms of supply (goods and/or services) presents a different challenge but international experience shows that any system with mixed liability goods will present difficulties even at the very start of the supply chain. As soon as goods are excluded there is a great potential for mis-description, both accidentally and deliberately.

This matter is referred to again in Section 9, where there could be resulting delays in imports due to inadequate paperwork on declaration of goods imported.

Problems would also occur further down the supply chain in identifying taxed and untaxed goods at the point of supply, whether by segregation on tax invoices, or at the point of consumption using retail schemes.

Domestic energy

If the proposition was approved we would need to agree exactly what supplies were intended to be covered by "domestic energy". The proposition does not mention using the same liability treatment as in the U.K., but this would be a possibility. It should also be stressed that in the U.K. all forms of energy supplies are taxed under VAT but what are described as "qualifying supplies" are eligible to be taxed at the lower 5% rate rather than the standard rate of 15%. The qualifying supplies use quantitative measures to determine what is intended as being "domestic" and as such are taxed at the lower rate of 5%. This U.K. system could be adopted in Jersey to determine what is eligible for zero-rating.

8. Impact on businesses

The U.K. exclusions are wide-ranging, and if replicated in Jersey would impact on a wide range of businesses, including hotels, restaurants, cafés, takeaways, bakeries, butchers, fishmongers, agricultural merchants, farmers, garden centres, pet shops and chemists. Perhaps there would be less of a challenge for the large supermarket importing pre-priced goods for resale in the same state, but the changes do not simply affect those that supply direct to the public but also importers, manufacturers and wholesalers.

If P.28/2009 was approved by the States it is estimated that approximately 400 businesses would be affected by the changed liability of supplies.

Accounting systems

If the proposed exclusions were approved, the GST-registered businesses involved would need to make significant changes to their accounting systems. This task should be easier for businesses using automated systems, but we should not underestimate the availability of software, the time needed to implement changes and the costs involved. Many U.K. software suppliers will not supply into Jersey; they make most of their profit from post-sales support, and the costs of providing this to a customer in Jersey make it unattractive to do so.

Many smaller businesses do not have computer-based accounting, so the impact of complex GST liability may fall disproportionately on them (e.g. market stall traders).

Increased complexity

In most GST/VAT systems, the basic accounting record for registered businesses is the tax invoice which must be issued for all taxable supplies. Retailers are, however, allowed to assess tax on their sales by use of retail scheme instead. Because of the complexity of the VAT system in the U.K. they now have 8 different retail schemes and bespoke systems which must be approved by Her Majesty's Revenue and Customs. In Jersey GST we only need one retail scheme at present as all sales are currently taxable. If the proposition was approved we anticipate that we would need to provide 6 different retail schemes.

9. Impact on administration

"One overriding lesson about VAT/GST design is that adding tax preferences (exclusions by zero-rating/exemption) to the system may satisfy economic, distributional or other policy goals but at a cost. Tax preferences – in the form of zero-rates, exemptions or reduced rates – reduce revenue, add complexity and increase compliance risks. The end result is an increase in compliance burden for businesses and administrative costs for Government". [Concluding comment from a U.S. Government Accounting Office report – "VAT lessons from other countries"; dated April 2008].

There still seems to be general misunderstanding on the part of many States members as to the inter-relationship between the design of a tax system and the compliance risks; compliance costs and administration costs. In some ways this is understandable – it is a complex issue which was unfortunately not helped by the Corporate Services Scrutiny Panel's first interim report on GST (S.R.6/2006) – dated October 2006. Section 6 covers compliance and appears to rely on an Australian Senate Select Committee review dating back to April 1999, which in turn quotes from a U.K. National Audit Office study into compliance costs in 1995. Although we have generally been impressed with the work of the Corporate Scrutiny Panel on GST (the conduct, methodology and outputs) we have never accepted these conclusions which are not evidence-based and focus mainly on business compliance costs.

The Scrutiny Panel findings have repeatedly been misinterpreted in previous propositions and this P.28/2009 is no exception. The comment under the heading **'Financial/manpower statement'** includes "as was demonstrated convincingly by Scrutiny, claims of excessive administration cost associated with exemptions or zero-rating were grossly overstated". Scrutiny demonstrated no such thing, and the Panel members have never seen the NAO report. If they had, they would have seen an important footnote in the comparison of gross compliance costs – "The purpose of this comparison is to illustrate the similarity of the compliance cost: turnover curve. Comparison between individual countries figures [U.K.; Netherlands; New Zealand; Germany; Canada] are not valid because the tax regimes are different and the research has been carried on a different basis". Finally it must be emphasized that the NAO report was a study into the "Cost to Business of Complying with VAT requirements" and not the cost of administration of VAT by H.M. Customs and Excise. It is our view that this quote has been taken out of context, and has then been misinterpreted by various readers.

Based on more recent research by Her Majesty's Revenue and Customs which is referred to as the "Compliance Continuum", it is certain that voluntary compliance would decline as a result of having a complicated GST system. The tax gap (measured as the difference between actual revenue receipts and potential yield) would increase as a result of the range of exclusions suggested by the proposition.

The complexity of the system has a major influence on most of these factors. The U.K. National Audit Office reported in 1994 that VAT Audit Staff found under-declarations at 55% of traders visited. This is high by international standards and was still occurring after 20 years of live tax experience and is a direct result of having a complicated VAT system.

Staffing numbers

It is difficult to quantify the exact additional administrative costs of these exclusions. However, a reasonable approximation based on U.K. experience is that 3 additional staff will be required; and the extra payroll, social security, IT, accommodation and other costs would be approximately £200,000 to £300,000 a year.

Therefore, the total cost to the States of these exclusions, in terms of direct loss of revenue and increased administration would be of the order of £6.25 million.

Customs and imports

Under the current GST Law, all goods imported into Jersey are potentially taxable (there is a *de minimis* value below which goods will enter freely). Under these circumstances our proposed clearance procedures are simple, and have been welcomed by the main importers and Chamber of Commerce.

However, if the proposed exclusions are approved, circumstances will be very different. Goods imported into Jersey will either be subject to 3% or 0% GST. Firstly Customs will be required to maintain an up-to-date and accurate Tariff to include a GST liability indicator for all commodities. Inevitably this will lead to additional problems of mis-description and perhaps a combination of mis-description and under-valuation.

This will undoubtedly require additional staffing for Customs, and for non-GST registered importers has the potential to lead to delays in the clearance of incoming goods.

10. Impact on the public

Little change in prices – recent U.K. experience (December 2008)

Would prices fall to reflect a change in GST liability to exempt or zero-rate? Based on international experience the potential savings are seldom passed on in full. The most recent example is the temporary reduction of the U.K. standard rate from 17.5% to 15% in December 2008. Consumers appear to have benefited from the one-off reduction mainly on single higher value goods (e.g. cars, electrical goods) and supplies in the service sector. Many retail prices have not changed at all but the VAT registered businesses will certainly be accounting for the tax to U.K. Revenue and Customs at the reduced rate of 15%.

The extra cost to business is difficult to quantify, but whatever it is, is likely to be passed on to consumers, rich and poor alike, in increased prices.

11. Other factors than need to be considered

Legislation and implementation time

If the proposition was approved we would need to make the necessary changes to the GST legislation by amending the Schedules in the Law by Regulations. This would involve legislative drafting and then securing time in the States Assembly. The actual implementation date would need to be agreed in consultation with the business community taking into account the following –

- How long it would take businesses to make necessary changes to accounting and stock control systems, advertising and price marking – especially in-store;
- Consultation followed by design, agreement with businesses and trade bodies, of new Retail Schemes that would be needed to deal with mixed liability sales; and
- Length of time required for the GST team and Customs to re-educate the businesses directly involved.

Review and Appeal

The added complexity would ensure many more rulings having to be made, requests for extra-statutory concessions, and appeals before independent Commissioners of Appeal – which would all take research, time and care to prepare. There would have to be more control visits by Income Tax auditors to traders' premises to ensure the increasingly complex GST regime is being accounted for correctly. Any discovery of an under-declaration would lead to an assessment notice, and possibly penalties, which again could result in a formal appeal by the business involved. This would all lead to a spiral of control visits/rulings/appeals which would be time-consuming and contentious. It should be remembered that formal appeals to a tribunal or the Commissioners are just the tip of the iceberg. Most appeals are resolved by an informal internal review mechanism involving senior officials not directly involved with the case. All reviews and appeals are exceedingly time-consuming for all concerned.

This would in turn also make the tax less acceptable to consumers and businesses, and could lead to further policing costs. Consequently, it could significantly add to the costs of the business, which would be passed on to their customers. This is not theory; this is what happens in the U.K. now.

Exclusion creep

When any exclusions are proposed or approved it tends to promote/encourage further requests for relief. This observation is based on international experience and the events in Jersey over the last 3 years have certainly supported this view. Since P.28/2009 was lodged there have been at least 3 approaches to Ministers for them to consider amendments to the proposition and further extend the scope of exclusion.

As can be seen from previous GST proposals in Jersey, there are wide and differing views on what can be described as essentials or "merit" supplies. But the whole process challenges the principle and credibility of what is intended as a simple GST.

12. What do other countries do?

It is true that some countries have a number of exclusions, or reduced rates, in their GST or VAT, but it is generally accepted that the most successful application of these taxes is in countries that have a simple broad-based tax, with a single rate and a high threshold. In fact, the countries generally held up as "best in class" are New Zealand and Singapore, where exclusions have been kept to a minimum.

The question of taxing food and other "essentials" is a policy question faced by all countries that have implemented a VAT/GST style system (currently around 150). The majority appear to have no problem in taxing what is a major component of domestic consumption, particularly where this is linked to an income support system to protect the less well-off.

Under the EU VAT system food must be taxed; the standard rate of VAT must be at least 15% although member states may opt to use a lower rate (which must be at least 5%).

Currently the U.K. treatment of food under VAT is non-compliant within the EU VAT Directives – it is only allowed to continue (with Eire) under a transitional relief which is reviewed every 3 years and which expires at the end of 2011.

13. Current level of support given as a food exclusion substitute

The proposition includes a list of the various measures introduced by the States to compensate/mitigate the effects of GST as listed below –

- increased tax thresholds by an extra 3.5% from 3% to 6.5% for 2008 in the 2008 Budget at a cost of £4 million;
- included protection from GST for those on the original income support at a cost of £1.75 million;
- an allowance for those households between the income support scheme and income tax system known as the GST bonus scheme at a cost of £0.4 million;
- the Le Fondré proposition P.138/2008 to further increase income support by £3 million, double the GST Bonus Scheme at a cost of a further £0.4 million and provide an increase in income tax exemption thresholds from 3% to 5% in 2009 at a cost of £2.4 million.

This equates to a total financial benefit on those on low to middle incomes of £12 million, twice the benefit of removing GST from food and domestic fuel.

It would not be unreasonable to suggest that if the proposition was approved all of the above would firstly need to be reviewed. Those introduced directly as a result of food remaining taxed under GST could be withdrawn and other allowances reduced.

14. Progressive alternatives

The proposition includes a request that the Treasury should investigate whether alternative progressive tax measures could be brought forward for approval to restore the revenue forgone (estimated as £6 million) from the proposed GST exclusions.

This would be a repeat of the lengthy debate the States has already had on which tax option is the most suitable to compensate for the revenue lost under 0/10 – income tax; payroll tax; or GST. The 3 main options were investigated at length and the States agreed that GST was by far the best option. Nothing has happened since to change this conclusion.

As has been stated previously, the States should not even be considering reducing its tax base at the present time given the many uncertainties that lie ahead for the economy and States' finances.. If the proposition is approved by the States we would have no alternative but to recover the lost revenue and by appraising, prior to removing GST from food and domestic fuel, one of the following options:

Increasing rate of GST

The current rate of GST would need to be increased from 3% to 4%.

Income tax

The tax rate would need to be raised to 21% – this would net an additional £9 million from individuals and partnerships based on the 2007 year of assessment (2008 collection).

Raising the social security ceiling

To raise £6 million a surcharge of 2% on annual earnings above the current £42,480 Social Security ceiling would be required.

15. External advice on GST

Since the last debate on GST, exclusions we have received advice from 2 independent sources, both of whom support the stance taken by the States in terms of the simple GST with few exclusions.

Fiscal Policy Panel (FPP)

The FPP's remit is to advise the States mainly on high level macro-economic issues. Under Section 5 of their 2008 Annual Report they recommended that ***the States does not approve decisions as part of the Business plan or Budget that undermines the tax base.*** More recently during a presentation in January 2009 to States members on their update, the Panel commended the States for not exempting food from GST, on the basis that the States Policy of having a broad-based tax with few exclusions, and increasing income support and tax allowances, provides far greater benefit to those on low to middle incomes than blanket exclusions.

H.M. Revenue and Customs (HMR&C)

The previous Minister for Treasury and Resources had always promised that GST would be the subject of an external independent review before the end of 2008. This post-implementation review was performed by a team from Her Majesty's Revenue and Customs in December 2008. Their report, which was released to the public domain in January 2009, was accepted in full. The first of 14 recommendations stated that – ***"GST should remain substantially as implemented and bedded in for at least a period of 2 years without any significant changes".***

16. Circumstances have changed dramatically since the last debate in September 2008

Members will not need reminding of the dramatic changes to world economies fuelled by the global financial crisis that have occurred since the last debate. In September 2008 the main concern was the price spiral influenced by crude oil prices, and in particular the hike in food prices. There was also a backdrop of buoyant tax receipts in Jersey which in many previous years had exceeded targets. There was even a belief that GST revenues would also be significantly higher than predicted, and that further exclusions could be afforded without need to recover the shortfall.

However, the world has changed dramatically since September 2008, with oil prices down reduced by a half following the global economic downturn. Deflation, rather than inflation, is now the major concern, and the Jersey RPI is falling fast. Most governments throughout the world now face intense fiscal pressure and uncertainty in the levels of revenue streams, particularly those relying on traditional direct taxes. With businesses closing, job losses, increased unemployment and companies reporting reduced profits, government revenues are declining and expenditure on benefits is increasing. The countries under greatest pressure will be those where financial institutions play the largest role in the economy. Jersey is no different and although revenue receipts are likely to remain on target for 2008, at this stage it is difficult to predict precisely what the impact will be from 2009 onwards, though it is certain tax revenues will decline significantly. For this reason alone if there was ever a time not to be reducing the tax base by adopting further GST exclusions – it is now.

17. Conclusion

The Fiscal Strategy should and must be taken as a package. The individual elements of taxation, economic growth and, crucially, Income Support have been designed to complement each other. Whilst GST by itself may be considered slightly regressive, the package overall produces a progressive effect.

Furthermore, the Income Support proposals approved by the States have insulated those on low incomes from the effect of GST, and income tax exemptions have been increased for those on middle incomes. It is universally accepted that this is a far more effective way of protecting the less well-off from the effects of GST than blanket exclusions.

In summary – the States has decided on a number of occasions that a simple GST system broad-based with a low rate and few exclusions was the most cost-effective way forward to fill the black hole. This decision has been vindicated by the performance of GST so far. The States repeatedly made this decision in the full

knowledge that a broad-based GST would be, on its own, slightly regressive. There were good reasons for this:

- GST was never meant to be considered in isolation, but instead always intended to be part of a tax package with the progressive elements being '20% means 20%' and Income Support;

- the current broad-based GST has enabled a low 3% rate which is the lowest in the world;

- exclusions do not make the package significantly more progressive;

- if the exclusions were approved the revenue loss of £6 million must be recovered;

- exclusions significantly increase the complexity of the tax and hence the proportion of the tax that is spent on administration, plus adding to business overheads which, ultimately, the public will end up paying for through increased prices;

- GST is a success but the system must be allowed to consolidate before any major change;

- all previous debates took place in a completely different world economic climate – now is definitely not the time to be reducing the tax base and thereby increasing levels of uncertainty;

- granting exclusions from GST encourages yet more calls for further exclusions which undermine confidence and credibility in the system.

It has recently been stated that there are no plans to increase existing rates of tax (including GST) or introduce any new taxes. If the exclusions were approved these plans would certainly need to be reviewed.

The Minister for Treasury and Resources therefore urges States Members, for the reasons given above, to reject the proposal for further exclusions as outlined in Projet 28/2009.